AUTUMN STATEMENT 2012 BRIEFING NOTE

Paint the big picture, George

PRINCIPLES

1. Economic necessity must trump political expediency
It now looks probable that the Chancellor will not meet either of his fiscal rules (as we originally forecast in August): in particular, debt in 2015/16 is likely to be between £20 billion and £30 billion higher than the amount necessary for debt to be on a downward path by the end of that financial year.

Despite the political embarrassment that this will cause, the Chancellor should resist the temptation to use any accounting tricks (e.g. transferring of the interest payments from Quantitative Easing (QE) to the Treasury) to try to meet the rules. Rather, he should provide hard evidence that the Coalition will take active steps to put the government finances on a sustainable debt path. With low growth likely in the short term, this means substantial further spending cuts will have to be set out in the coming years.

2. Rules aren't everything
Many in Westminster seem to believe that the bond markets are reassured by the existence of fiscal rules. Our research, to be published in the New Year, suggests that this is not the case. What markets will respect is the implementation of long-term policies which will restore the nation's finances to robust health.

3. Remember tax simplification
In Opposition, George Osborne repeatedly advocated the need for a radical programme of tax simplification (not least, in setting up the Tax Reform Commission under Lord Forsyth and then, on taking office, establishing the Office for Tax Simplification). Recently, however, he seems to have forgotten his earlier enthusiasm: the tax code is now spiralling out of control. Recent Finance Acts have been longer than ever:

- the Finance Act 2011 was 240 pages in Tolleys, (93 sections and 26 schedules)
- the Finance Act 2012 was 378 pages in Tolleys (239 sections and 39 schedules)

4. No more sweeties
All Chancellors face the temptation to dole out taxpayers' money on various schemes. The last Budget, for example, saw: £100 million for new research facilities at universities, £60 million to establish a UK centre for aerodynamics, an additional £50 million for broadband, tax breaks for video games, animation and high end TV industries, £3 billion for oil and gas exploration, £1.2 billion of infrastructure investment in Manchester, £150 million for other northern cities, an increase in the Growing Places fund of £270 million, £15 million for improving the safety of cycling and a range of other commitments.

These initiatives may or may not be worthwhile. What is clear is that they are no longer affordable.

5. No more gimmicks
The 2012 Budget was widely criticised for the number of ill-considered micro-initiatives it contained, many of which were later dropped (the pasty tax, the philanthropy tax, the caravan tax, and the tax treatment of improvements or alterations to listed church buildings).

The UK Government is spending almost £700 billion a year (or just under £2 billion a day, the equivalent of about £80 for every household in the country). We need far less tinkering, not more.

SUMMARY OF RECOMMENDED POLICIES

THE DEBT TARGET AND THE PATH OF GOVERNMENT SPENDING

Recommendation 1: It now looks almost certain the Government will miss its net debt target on unchanged policies. In the Autumn Statement, the Government should acknowledge that further spending restraint is going to be necessary. It should not, however, react to any failure to meet the rule with rash, ill-thought-through spending or tax announcements, or accounting tricks to conceal it.

Recommendation 2: Instead, the Chancellor should set out the necessity for and scope of the next Spending Review, which should set out a path to reducing the spending-to-GDP ratio to 38% within four years (the average tax-to-GDP ratio since 2000/01).

Recommendation 3: This should include a thorough review of eligibility for government transfers, both for working age and retirement benefits, and education and health services. In particular, it should examine: the path of the state retirement age, eligibility for non-retirement pensioner benefits, the scope of tax credits, the availability of NHS services to non-British nationals, prescription drug provision within the NHS and the potential for a voucher scheme in education provision.

IMMEDIATE POLICY DECISIONS - PUBLIC EXPENDITURE (estimated saving/cost in 2013/14)

The simplest way for the Chancellor to save money in the shorter-term is to implement cash freezes to several spending streams:

Recommendation 4: freeze all benefits which would usually be increased by the September CPI inflation rate for one year, except for the state pension (reported saving of £7 billion).

Recommendation 5: freeze the international aid budget at 0.55% of GDP (estimated saving £2.3 billion).

Recommendation 6: create a clear framework and guidelines for public sector pay restraint.

IMMEDIATE POLICY DECISIONS – TAX

Our current tax system is a mess. The Autumn Statement should not include higher burdens and more complication, but rather should seek to simplify and lower rates where possible.

Recommendation 7: commit to no further increase in the tax burden on the economy, and avoid introducing new taxes or council tax bands.

Recommendation 8: embark on a revenue neutral tax reform programme according to the principles of broadening bases and lowering marginal rates, starting with the full merging of income tax and employees' National Insurance into a single income tax rate (with employers' National Insurance replaced with a simple payroll tax).

Recommendation 9: reduce the main rate of Capital Gains Tax to its revenue maximising level (estimated small increase in revenue).

Recommendation 10: eliminate higher rate pension tax relief, and as a quid pro quo, reinstate the 10p tax rebate on pension assets' dividends and interest income (estimated saving £3 billion). In addition, combine the annual contribution limits for tax relief on ISA and pension saving at no more than £40,000.

Recommendation 11: replace the 25% tax-free lump sum concession with a 5% "top-up" of the pension pot (cost neutral).

GETTING THE SUPPLY-SIDE RIGHT

Recommendation 12: abandon the unilateral carbon price floor planned for 2013 (estimated cost £740m).

Recommendation 13: exempt permanently all small businesses (0-10 employees) from a range of regulatory and employment legislation burdens, including: the extension of flexible working regulations; requests for time off for training; pension auto-enrolment.

Recommendation 14: create a new 'no fault dismissal' for underperforming employees after two years of employment, which would work in parallel to 'unfair dismissal'.

Recommendation 15: roll out a framework for effective 'sunset clauses' for new regulations.

Recommendation 16: reverse the nationalisation of development, first introduced under the Town & Country Planning Act 1947. In its place, adopt a new Consolidated Act which rationalises all the 100+ Statutes that impact on planning and development. New garden city development should also be encouraged.

COMMENT

Ryan Bourne, Head of Economic Research at the Centre for Policy Studies said:

"What's become clear since the 2010 Emergency Budget and Comprehensive Spending Review is that assumptions about the potential underlying growth of the economy and the strength of tax revenues have been over-optimistic. It is now likely the Government will miss its net debt target on unchanged policies. The particular rule in itself is relatively unimportant. What really matters is that the Coalition remains committed to getting our debt burden on a downward path. In the short term, spending on benefits, aid and public sector pay can all be frozen. But it's increasingly obvious that a further spending review is necessary, and this should go further in looking at the scope of government activity, including eligibility for government transfers. The coming demographic squeeze makes this all the more pressing."

Tim Knox, Director of the Centre for Policy Studies said:

"The Chancellor has a choice: will he put the long-term economic health of the country above the temptations of short-term political gain? If he tweaks the numbers to meet his rules and if he announces a wide range of policy initiatives which might grab a few headlines, then we will know that this is a Statement inspired more by politics than economics. What would be preferable is the recognition that the current fiscal pressures and long-term demographic trends require a great reduction in government activity and coherent simplification of our dysfunctional tax system."

AUTUMN STATEMENT BRIEFING

The Background

This note attempts to set out some of the key challenges and decisions the Chancellor will have to face in the build-up to his Autumn Statement on December 5th.

In particular, we examine three key areas which the Chancellor should be considering:

a) What to do about his fiscal targets
b) How to begin preparation for the next Spending Review
c) What discretionary fiscal policy changes the Chancellor should make now

We believe the recommendations outlined here are pragmatic steps which could be taken to put the UK public finances on a sustainable path while improving our medium-term growth potential.

The Chancellor's fiscal rules

In June 2010, the incoming Coalition Government set itself two fiscal rules in order to lower the budget deficit and get government debt on a downward path:

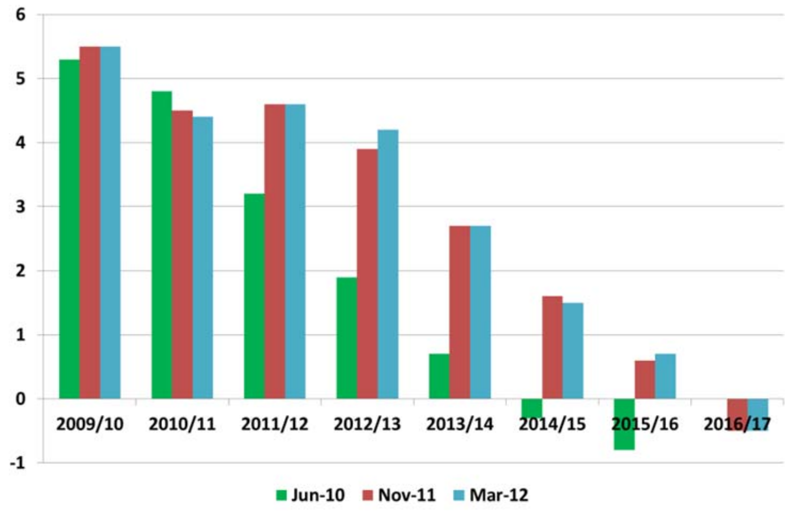
1) **The fiscal mandate:** the cyclically-adjusted current budget should balance at the end of a rolling five-year forecast period, which was initially 2015/16.

2) **A supplementary debt target:** the net-debt to GDP ratio should be falling by 2015/16.

The first of these rules is largely meaningless. The Chancellor has since utilised the 'rolling' aspect of the mandate, meaning the Government only ever has to commit to eliminating the current structural deficit *within* five years. In addition, identifying the 'cyclically-adjusted' current budget means relying on modelling of the size of the output gap of the economy, on which there is deep division among economic forecasters and constant revisions made by the Office for Budget Responsibility (OBR).

Chart 1 below shows how attempts to hit this first rule have evolved since June 2010. Slower than expected growth and an upward revision to the size of the structural deficit has meant that the last OBR forecasts suggested the structural current deficit would not be eliminated until 2016/17, and has only fallen by 13% between 2009/10 and 2011/12 on the most recent estimates.

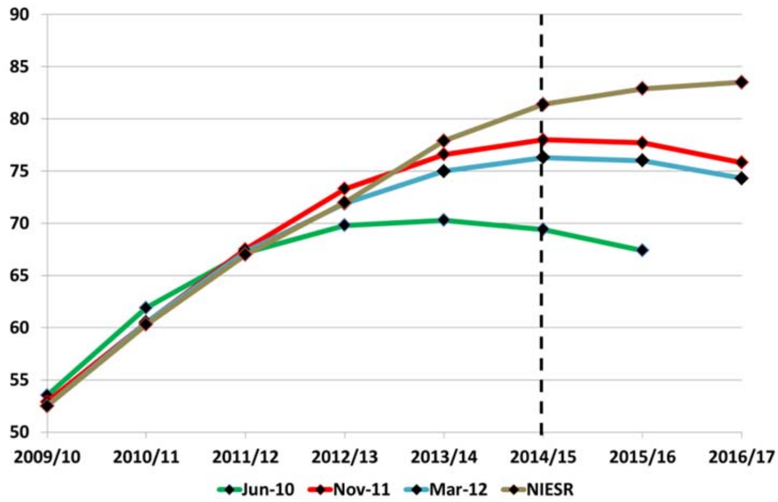
CHART 1: CYCLICALLY-ADJUSTED CURRENT BUDGET DEFICIT FORECASTS



The second rule for the path of public debt was firmer. Public sector net debt was, in June 2010, forecast to peak in 2013/14 before being on a downward path thereafter (as shown in Chart 2).

Budget 2012 revised this, suggesting that it would peak much higher in 2014/15 before falling in the next Parliament. With borrowing higher than expected so far in this financial year, and GDP growth lower, it now seems that even this second fiscal mandate will no longer be met. The National Institute of Economic and Social Research's recent forecast suggests that the debt-to-GDP ratio will still be rising before peaking in 2016/17.

CHART 2: PUBLIC SECTOR NET DEBT AS A PROPORTION OF GDP



Our calculations suggest that debt in 2015/16 will be between £20-30 billion higher than the amount necessary for debt to be on a downward path by the end of that financial year. The Chancellor therefore must decide whether to abandon his supplementary debt target, or to undertake further fiscal consolidation in order to meet it. We are assuming here, that he does not use accounting tricks to meet the rule, e.g. by including the transferring of the interest payments from QE to the Treasury.[1]

Many have claimed that abandonment of the supplementary debt target in the Autumn Statement would lead to an adverse reaction in the bond markets. We do not believe this to be the case, as most will have already have factored in that the rule will not be met.

However, continued favourable market conditions should not be taken for granted. What's required is evidence that the Government is taking active steps to put us on a sustainable debt path. Continued sluggish growth on existing spending plans would mean a much higher debt-to-GDP ratio than expected by the end of the Parliament. Cuts to current expenditure thus far have been modest, and the fiscal plan was heavily reliant on a strong underlying growth rate, generating substantial increases in tax receipts. These now look unlikely to be forthcoming on unchanged policies. Despite meeting overall spending plans, the Government has thus been borrowing much more than expected. We therefore expect that substantial further spending cuts will have to be made in the coming years.

It would be preferential to make these decisions sooner rather than later, and in the long term lower public expenditure would improve economic growth prospects. But further fiscal consolidation should not be rushed in order to hit a target which has little economic, but plenty of political, rationale.

[1] The Institute for Fiscal Studies outlined in more detail why this would be disingenuous: Autumn Statement 2012: more fiscal pain to come?

What is more important than the precise rule is that the Government can demonstrate, through action, its determination to reduce government spending and do whatever it can on the supply-side for growth to get the debt-to-GDP ratio on a downward path. In the short-term, this means restraining spending growth where possible. But it also means a further spending review with wider scope is important to set out a longer-term vision for government expenditure.

Recommendation 1: the Government should acknowledge the need for further spending restraint going forward, but not react to any indication from the OBR of failure to hit its debt target with rash spending or tax announcements, or accounting tricks to conceal it.

Recommendation 2: instead, the Chancellor should set out the necessity for and scope of the next Spending Review, which should set out a path to reducing the spending-to-GDP ratio to 38% within four years (the average tax-to-GDP ratio since 2000/01).

A 'comprehensive' Comprehensive Spending Review[2]

Given the observed over-reliance of the current fiscal strategy on optimistic tax revenue forecasts, this next spending review will be extremely important. But it's clear from international experience and from the outcomes of the previous spending review that there are lessons which need to be learned.

Our report into the example of Canada, and recent economic analysis, shows that spending restraint tends to be most effective when it is accompanied by significant reforms to both the scope and delivery of state programmes.[3] Attempting to make spending cuts across the board is second-best. In these circumstances, departments tend to postpone capital spending, including such things as maintenance and repair. This can often be a false saving as spending later grows back to former levels within a few years.

It is far better to think about what we want the state to do and to eliminate whole programmes which fail to fulfil objectives. The first Comprehensive Spending Review seemed to proceed in the more undesirable salami-slicing fashion. Both health and foreign aid were ring-fenced for political reasons, and there was no real questioning about the scope of the state – rather, it was an exercise in providing similar services more efficiently.

The next spending review must[4]:

- Prioritise improving the UK's medium term economic growth rate.[5]
- Not ring-fence departments, but instead judge all spending according to its aims and effectiveness. With spending on education, health, debt interest and welfare now

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2 Sharpening the axe: comprehensive spending review II? by Ryan Bourne and Tim Knox, Centre for Policy Studies Growth Bulletin 2012.

3 How to Cut Government Spending: Lessons from Canada by Tim Knox and Brian Lee Cowley, Centre for Policy Studies 2012 .

4 Several of these recommendations are drawn from the detailed work undertaken by Lombard Street Research's Brian Reading, whose report The Blunt Axe reviewed the methodology behind the Government's Comprehensive Spending Review.

5 Contrary to what many claim, this is not incompatible with lower government spending. For example, A Afonso and D Furceri estimated that a percentage point increase in the tax revenues to GDP ratio, on average, reduces output growth by 0.12% for OECD and EU countries. See Government Size, Composition, Volatility and Economic Growth, European Central Bank Working Paper Series No 849, 2008. Similarly, an influential work of Robert Barro has previously shown that growth is inversely related to the share of government consumption in GDP. See "Economic Growth in a Cross Section of Countries", The Quarterly Journal of Economics, Vol. 106, No. 2,1992.

accounting for 72% of overall spending, big decisions will have to be made about the effectiveness of some of the essential functions of government.

- Identify front-line work and account for the number of 'frontline workers'.
- Take account of relative prices to see how spending limits will affect government output.[6]
- Think through the scope of what government should do, eliminating whole government programmes and rationalising departments where necessary.

In addition, the next spending review should establish a mini-commission to review eligibility for government transfers.

Our recent report into state transfers showed that around three million more households were net recipients of the state in 2010/11 than just ten years earlier, with 53.4 per cent of households now net recipients (up almost 10 percentage points from 2000/01).[7] Some of this is driven by an ageing population, but similar trends were seen for non-retired households.

Recommendation 3: Give detailed thought to the eligibility for government transfers, including both working age and retirement benefits, and education and health provision. This should include reviewing:

- **The state retirement age: in particular, how this might be linked to life expectancy to make the public finances more sustainable[8]**
- **Eligibility for non-retirement pensioner benefits, such as winter fuel allowance, free TV licenses and bus passes**
- **The tax credits system: in particular, the potential to reform towards an earned income tax credit system[9]**
- **Access to NHS treatment for non-British nationals**
- **Prescription drugs provision within the NHS**
- **The potential for a voucher system to operate in education provision**

Discretionary policy changes - spending

The importance of the decisions taken in a genuinely comprehensive spending review for our long-term fiscal health should not be underestimated. But it may be that the Government feels it has to make some immediate savings in order to retain credibility that it is committed to fixing the UK's public finances. Thus far the Government has delivered on its overall planned spending restraint, but it has found controlling certain spending (like the social security budget) more difficult. The most obvious way to keep spending down, on top of the fiscal consolidation already planned, is to implement spending freezes.

Recommendation 4: freeze benefits in cash terms for one year (saves £7 billion)

Last year's Autumn Statement saw a host of benefits, including out-of-work benefits, uprated in line with the September 2011 annual CPI inflation rate of 5.2 per cent, at a time when average pay was increasing by 2.1 per cent.[10] This year the September inflation rate was 2.2 per cent and average total pay is rising by 1.8 per cent. Given the above earnings growth increase last year, the Government should implement cash freezes in benefits which were uprated by 5.2 per cent for 2012/13. Recent

[6] We know that some sectors, like health for example, can experience very different inflation rates.

[7] The progressivity of UK taxes and transfers by Ryan Bourne, Centre for Policy Studies 2012.

[8] The state pension makes up around £63 billion of total UK government spending. This year's OBR Fiscal Sustainability Report showed that the proportion of the population aged 65 and over is set to increase from 17% in 2011 to 26% in 2061.

[9] A better way to help the low paid by Rupert Darwall, Centre for Policy Studies 2006.

[10] For full details of the benefits uprated, read 2012 Benefit Uprating.

reports suggest that were these (excluding the state pension) to be frozen, it would save around £7 billion in one year.[11]

Recommendation 5: freeze in foreign aid budget (saves around £2.3 billion in 2013/14)[12]

The 0.7% target for international aid spending was originally based on the 'investment gap theory' which holds that developing countries can increase growth if rich countries fill the gap in investment. The idea is that because poor countries are unable to save enough to invest, aid spending can be used instead to increase capital investment and boost output. The 0.7% figure comes from the 42 year old estimation of the size of this gap. Not only have the estimates of this gap been revised significantly down, but more recent development theory shows that institutional quality is the real key to generating prosperity. As such, there is no rationale for the 0.7% target. This doesn't mean we should abandon all aid, much of which does good work. But, in light of the prolonged economic difficulties domestically, the aid budget should be frozen as a proportion of GDP at 0.55%.

Recommendation 6: public sector pay freeze[13]

In 2010, the UK Government set a public sector pay freeze for all those earning more than £21,000. Yet average earnings have increased in the public sector much more quickly than the Government expected. This is what led public sector layoffs to be much higher than expected. The *Financial Times* found that six Whitehall departments were unable to implement a full freeze, because of contractual obligations within official pay scales. Recent research by the Office for National Statistics suggests public sector workers now earn 7.3 per cent more than those in the private sector, even after controlling for age, skill level and occupation type.[14] Therefore, on grounds of fairness to taxpayers, it is likely the Government will seek to extend pay restraint within the public sector. To ensure this brings the planned savings, the Coalition must set a clear cross-government framework for how a freeze should be interpreted at a departmental level.

Discretionary policy changes – tax

Recommendation 7: no new taxes or new council tax bands.

The UK public finances are in a bad state because the Government spends too much, not because it taxes too little. Nevertheless, there has been increased discussion in political circles about the feasibility of a new wealth tax, or mansion tax on property, to ensure "the rich pay their fair share". Our research into the mansion tax showed that:

- the UK has a higher property tax burden than other OECD countries;
- high value property makes a disproportionate contribution to property tax revenue;
- new taxes on property would prove complex to administer, not least because of valuation issues.[15] Concessions would have to be sought for the cash poor and it would add complication to the tax system.

Furthermore, a wealth tax more broadly would either have to cover such a broad range of assets that it would be costly to administer, or narrowly focused that it would be unfair. Quite simply, new punitive taxes on targeted groups are neither necessary nor desirable, and should be ruled out by the Coalition.

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11 George Osborne wants two-year freeze in state benefits, The Independent, 19 September 2012.

12 Why targeting 0.7% of GDP is nonsense by Adam Memon, Centre for Policy Studies blog 2012.

13 Put the saver first by Michael Johnson, Centre for Policy Studies 2012.

14 ONS finds substantial public sector pay premium by Ryan Bourne, Centre for Policy Studies blog 2012.

15 Taxing Mansions: the taxation of high value residential property by Lucian Cook, Centre for Policy Studies 2012.

It has been suggested high-value properties pay a disproportionately low share of council tax. As a concession to the Lib Dem pressure for a mansion tax, many commentators and Conservatives have suggested the introduction of two new council tax bands for high-value property, as has been undertaken in Wales. This seems unlikely to happen, not least because the Secretary of States for the Department of Communities and Local Government Eric Pickles and Exchequer Secretary to the Treasury David Gauke, have both ruled out council tax revaluation during this Parliament. Though the current bands are no doubt out-of-date, there are solid practical reasons to avoid a revaluation now. The cost of £260 million would be difficult to justify. And even simply looking at the top two council tax bands would require 940,000 properties to have to be revalued. This would lead to lots of political difficulties for very minor revenue gain.

Recommendation 8: no more tax sweeties – time to simplify the system[16]

The Government shows little desire to engage with proposals for substantive tax reform. The tax code is now spiralling out of control in terms of its length. The Finance Act 2011 was 240 pages in Tolleys, (93 sections and 26 schedules) and the Finance Act 2012 was 378 pages in Tolleys (239 sections and 39 schedules). The Office for Tax Simplification, meanwhile, has been reduced to examining a few bits of tax law, without any particular strategy. We badly need a more philosophical approach along the broad-base, low marginal rate principles, not more Gordon Brown style tinkering. The most recent Budget shows how politically damaging bungled tax reform can be, especially if it is not accompanied by lower rates. The Government should take the first step of applying these principles to the Corporation Tax system, which has come in for widespread criticism following public evidence of tax avoidance by companies. On a revenue neutral basis, it should systematically close loopholes to allow cuts to the headline rate. In addition, the Government should set out a timetable for the complete abolition of National Insurance Contributions, and their replacement with a single income tax and a new payroll tax to replace employers' NICs.[17]

Recommendation 9: reduce the main rate of Capital Gains Tax[18]

Capital Gains Tax (CGT) is economically a bad tax: it discourages entrepreneurship, savings and investment and so reduces economic growth; it distorts capital markets by encouraging individuals to hold on to assets that would be better off under different ownership; it channels funds into tax-exempt assets rather than those with the highest return. In fact, the sheer number of exemptions introduced by governments of all stripes is a tacit admission that CGT is a bad tax. If the Treasury's justification for a top rate of CGT at 28% was that this rate was 'revenue maximising' with a 50p top rate of income tax, this will no longer be the case when the top rate of income tax is reduced to 45%. In fact, then the CGT will be ABOVE the revenue maximising rate, and completely self-defeating. There is no excuse for the Treasury not to cut CGT immediately to about 25% (which is where the Treasury model would suggest it should now be to maximise revenue). Even further, we consider the Treasury's assumptions too pessimistic. Returning to the flat rate 18% rate would cost between £300 million and £900 million under their pessimistic assumptions, but bring with it a positive impact on economic growth.

Recommendation 10: abolish higher rate pension tax relief, reintroduce the 10p tax rebate on pension assets' dividends and interest income, and combine the annual contribution limits for tax relief on ISA and pension saving at no more than £40,000.

A recent Financial Times article suggested that the Chancellor was considering cutting the annual pension contribution exempt from tax to £40,000 or £30,000, saving either £600 million or £1.8 billion respectively.[19] Rather than fiddling about with these limits the Government should think more deeply about the effectiveness of the current pension tax relief system in catalysing a savings culture.

16 Tax Simplification: How, and why, it must be done by David Martin, Centre for Policy Studies 2005.

17 Abolish NICs by David Martin, Centre for Policy Studies 2012.

18 The Case Against CGT by Howard Flight and Oliver Latham, Centre for Policy Studies 2012.

19 Osborne casts eyes on pensions of rich, Financial Times, 19 November 2012.

Retirement tax incentives today are crude and misdirected, with distribution skewed towards the wealthy, who are increasingly treating pensions tax relief as a tax planning tool, rather than as an incentive to save (only one in seven who pay a higher rate of tax in their working life pays higher rate tax in retirement). Conversely, tax relief is poorly understood by younger workers, and lacks any emotional resonance. The lure of tax relief on pension contributions (at 20% for nearly 90% of the population) is insufficient to overcome pensions' inherent lack of flexibility.

As a first step to reform, higher rate tax relief should be shelved, saving some £7 billion annually and, as a quid pro quo, the 10p tax rebate on pension assets' dividends and interest income should be reinstated, costing roughly £4 billion per year. This would be part of a broader reform package.

In order to incentivise saving, the annual contribution limits for tax relief on ISA and pension saving should be combined at no more than £40,000, with the full limit available for saving within an ISA. This limit could be used as a key cost control lever, with adjustments to it (driven by affordability) becoming a regular feature in the Budget. A combined ISA and pension limit reflects the reality that ISAs, as perhaps the only remaining trusted brand in the savings arena, are popular. Indeed, last year, for the first time, more was invested in Stocks and Shares ISAs (£15.8 billion, up 26% on the previous year) than personal pensions (£14.3 billion), in spite of the latter having the added attraction of up-front tax relief.

Recommendation 11: the 25% tax-free lump sum concession should be replaced with a 5% "top-up" of the pension pot (cost neutral)

79% of individuals retiring with a private or company pension opted to take a tax-free lump sum entitlement upon retiring in 2011. Research from Prudential in July 2011 found that, subsequently, '43% of pensioners have been forced to live cautiously in retirement due to fears that their long-term retirement income will not be enough.' Many stated that they regretted taking the lump sum, as the large sums tended to be spent quickly on luxury goods. The 25% tax-free lump sum concession should be replaced with a 5% "top-up" of the pension pot prior to annuitisation. This would be of more lasting benefit to retirees (the "top-up" would increase people's annuity income) and would be cost neutral: 20% relief (higher rate relief having ended) on the 25% lump sum equates to the 5% "top up".

Supply-side changes

Recommendation 12: abandon the unilateral Carbon Price Floor proposed for 2013[20]

The UK is about to significantly ramp up the price its high energy users pay for carbon emissions. In the March 2011 Budget, the Chancellor announced a new unilateral UK carbon price floor (to be known as the Carbon Price Support). This is scheduled to start on April 1 2013 and will, if introduced as currently planned, more than double the price paid from the current level of £6.30/tonne to £16/tonne in 2013 – an increase of 156%. By 2020 UK electricity generators would be paying nearly twice as much for its carbon emissions as its EU counterparts. The Government therefore seems intent on artificially raising the price of carbon at the same time as it intends to embark on a new dash for gas. This is bad news for households and industry. The Coalition's own figures estimate that the carbon price floor will add between 1% and 2% to electricity bills in 2013, rising to around 6% by 2016. With many people already struggling to pay their energy bills, this could be damaging, especially for those on low and medium incomes, where a rise of six per cent on household energy costs will add £25 to the average family bill. The UK should scrap the carbon price floor and instead concentrate on a pan-European strategy of strengthening the price of EU Allowances in the EU Emissions Trading Scheme.

Recommendation 13: exempt permanently all small businesses (0-10 employees) from a range of regulatory and employment legislation burdens, including: the extension of flexible working regulations; requests for time off for training; pension auto-enrolment.[21]

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[20] Why the Chancellor must abandon the Carbon Price Support by Tony Lodge, Centre for Policy Studies blog 2012.

Small firms and startups created two-thirds of new jobs each year between 1998 and 2010. One-third of members of the Federation of Small Businesses cite the regulatory burden as the biggest barrier to their business, behind only cash flow and the recession. Exemptions should be granted from a series of recent and proposed changes in employment law to encourage small businesses and start-ups to expand, thereby hiring more people and creating new jobs. Small businesses should be excluded permanently from legislation to give all staff the right to flexible working, time off for training and pension auto-enrolment.

Recommendation 14: create a new 'no fault dismissal' for underperforming employees after two years of employment, which would work in parallel to 'unfair dismissal'.[22]

It should still be possible for an experienced employee to make a claim for being sacked unfairly. However, the definition of fair dismissal should be widened, for example, to encompass inadequate performance which falls short of the current standard of inherent inability or neglectful incompetence, to allow greater scope for "no fault" dismissal for underperforming employees. A solution would be to run "no fault" dismissal in parallel with unfair dismissal, with both applying after a worker has been employed for two years.

Recommendation 15: roll out a framework for effective 'sunset clauses' for new regulations.[23]

Sunset clauses should be more widely adopted. We should introduce a post–implementation audit of each regulation three years after enactment and publish a comparison of the objectives, costs and benefits specified in the Regulatory Impact Assessment against what has happened in practice. This will inform the decision as to whether to repeal, amend or retain.

Recommendation 16: reverse the nationalisation of development, first introduced under the Town & Country Planning Act 1947. In its place, adopt a new Consolidated Act which rationalises all the 100+ Statutes that impact on planning and development. New garden city development should also be encouraged.[24]

A more market orientated approach is required to meet the pressing demand for housing of all types and to revive the construction industry, which is currently languishing in a government-induced torpor. The nationalisation of development, first introduced under the Town & Country Planning Act 1947, should be abolished. In its place, a new Consolidated Act should be adopted which rationalises all the 100+ Statutes that impact on planning and development. Planning gains need to be priced and recognised by a planning system that takes into account the economic case for a development. Currently, this is notably absent. In practice, the way in which planning has developed over the last 60 years has resulted in very damaging economic consequences for the country. The planning system has demonstrated time and time again its inability to handle the competing claims of development vis-a-vis protection and sustainable nurturing of the landscape and environment.

The renewed interest in Garden Cities is to be welcomed. For such a renaissance to be a success, however, the onus must be on involving the private sector to design, fund and build such developments in an attractive and sustainable manner. Any new developments should avoid the mistakes of yesteryear and build a full mix of housing rather than shun the owner occupied sector as happened, disastrously, in the past. Once a design framework has been agreed, development rights for the construction of these new urban centres should be auctioned and a range of house builders should be awarded contracts. In contrast to the original Garden Cities, a range of architects should be commissioned.

Ryan Bourne and Tim Knox, November 2012

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21 Escaping the Strait Jacket by Dominic Raab, Centre for Policy Studies 2011.

22 Escaping the Strait Jacket by Dominic Raab, Centre for Policy Studies 2011.

23 These recommendations trail a forthcoming Centre for Policy Studies report by Keith Boyfield.

24 These recommendations trail a forthcoming Centre for Policy Studies report by Keith Boyfield.